

No Shortcut to Fundamental Reform:

**A Path to Meaningful Reform of the Federal Universal
Service Program That Will Meet the Needs of Rural
Customers While Avoiding Costly Artificial
Constraints**

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Summary

The quality of the results depends on the process followed.

The Joint Board Recommendation and the Commission's NPRMs refer to the need for, and to an intention to undertake, a “comprehensive review” that can lead to “fundamental reform” of the federal universal service program. Unfortunately, both the Joint Board and Commission have omitted the essential step of conducting such a “comprehensive review,” and have instead jumped ahead to make several specific proposals to change individual elements of the program. This kind of piecemeal approach to making changes is simply not a path to the “fundamental reform” of the program that is needed.

Comment has been sought and received on these specific proposals and, not surprisingly, the review has been mixed: some parties have offered an emphatic “yes,” while others an equally-emphatic “no.” The underlying – and inescapable – problem with this process is that at this point in time, no party can provide a reasoned and factually supported answer to the question “Are the current proposals consistent with the overarching goals of the program, including any specific objectives adopted as a part of the needed ‘fundamental reform’?” because the necessary “comprehensive review” has yet to be conducted and specific objectives have yet to be set.

The result of this process has been the production of comments that reflect different parties’ interpretation of the ultimate objectives of the federal universal service program. Those who view the reimbursement of ILEC costs as

the ultimate *objective* of the program invariably favor the current proposals, which are designed primarily to ensure ILEC cost recovery. In contrast, those who instead view the ultimate objective of the program in terms of customer protection; that is, as a means of ensuring that customers who live and work in rural and high-cost areas have access to the services that they want and need – quality services that are reasonably comparable to those available to customers in urban areas – tend to view the current proposals as representing the application of artificial constraints and as inconsistent with the program’s goals.

In order to conduct a meaningful analysis of the current proposals, it is essential that the Commission first establish a set of objective criteria for this analysis. This will require the anticipated “comprehensive review” in order to identify program objectives, design a program mechanism that can be implemented to meet these objectives, and to develop a transition path from the existing mechanism to the new. In order for this process to be effective, the review must truly be comprehensive: all elements of the federal universal service program must be evaluated, and none can be declared to be exempt from meaningful analysis and possible change. In particular, it is essential that the *means* historically used to accomplish program objectives not be elevated to program objectives in and of themselves; put directly, the goal is not to duplicate or perpetuate “how it has been done,” but instead to objectively determine “how it should be done” in order to effectively and efficiently meet the program’s objectives.

The first step is the identification of program objectives. This paper proposes, consistent with the language of Section 254 of the Act and previous conclusions of the Joint Board and Commission, that the following objectives be adopted:

1. The program should be designed to be responsive to customer needs, and should not be designed based on the types of services that any group or category of carriers currently provides, or wants to provide.
2. The program should be designed, to the extent possible, to permit customers to express their desires and for the services supported by the program to evolve over time, ideally without direct intervention by regulators.
3. Consistent with the Act, the program should be technology neutral. Customers should be able to obtain the services they need, including services that may require a given underlying technology, and for their needs to continue to be met as they evolve and change over time.
4. Consistent with the Act, the program should be neutral with regard to type or category of provider.
5. The program should ensure service availability through a Provider Of Last Resort ("POLR"), but the identity of the POLR should be chosen by customers rather than established by the Commission. Because of their position as the "first in" providers, in many rural areas wireline ILECs may represent the only viable candidates to serve as a POLR in the immediate future. They should not, however, be presumed to be the POLRs into perpetuity, simply because they were first to enter the market using what was then the only available technology.
6. The program should encourage efficient investment and operation. Efficiency and low cost should be long term goals. Any mechanism adopted should not protect inefficient carriers any longer than is necessary to ensure POLR continuity.
7. The program should be structured to ensure these objectives are met while minimizing the size of the fund over the long term.

8. In order to ensure these objectives are met while minimizing the size of the fund over the long term, *the program must recognize a distinction between “high cost carriers” and “carriers serving high cost areas.”* The stated purpose of the federal universal service program is to ensure that customers in rural/high-cost areas have access to the services that they need and that are comparable to the services available in urban areas. In contrast, the purpose of the federal universal service program is *not* to ensure that a high-cost carrier, or indeed any given carrier, can recover its costs.

When identifying objectives, it is also essential that the Commission explicitly consider what is *not* a proper objective of the federal universal service program. For example, the appropriate level of support for a given area has historically been estimated based on the costs incurred by the ILEC serving the area, and the goal of ensuring service availability has been achieved by reimbursing the ILEC for these costs. But reimbursing carriers who serve rural or high cost areas is not, and has never been, an *objective* of the program: it is a means by which an end (ensuring service availability in areas where only one ubiquitous network is present) has been achieved. Similarly, because the ILECs have historically owned the only ubiquitous network in an area, maintaining the ILEC as a POLR has been used as a means of ensuring service availability, but – like cost reimbursement – maintaining the ILECs as POLRs has never an ultimate objective of the program. The current proposals, and certainly much of the comment received regarding the merit of those proposals, has failed to make the critical distinction between the *means* historically used to ensure an *end* has been reached, and the actual end goal itself. A meaningful analysis of the current proposals requires that such a distinction be made.

Once the objectives have been identified and a mechanism for reaching them developed, it will be necessary to develop a transition plan. A potential step along the transition path, including but not limited to the current proposals, should be evaluated based on whether it represents a step toward, or a step away from, the ultimate objectives.

Certain truths, however uncomfortable or inconvenient, must be honestly confronted.

The existing federal universal service program mechanism has been successful in meeting many of the program's objectives over time, particularly when the assumptions regarding market conditions and available technology upon which the existing mechanism is based have accurately matched conditions in the real world. This does not mean that the mechanism was perfect, though – “best available means” is not inherently equivalent to “best possible means.” The needed comprehensive review must include a consideration of how what may have been “best available” was not the same as “best possible.” Specifically, the review must consider the following:

First, one result of the existing federal universal service mechanism is that rural/high cost areas are being served in a way that is inherently inefficient. Much of this area is served by a very large number of very small carriers; carriers that now proudly (or at least loudly) proclaim that they are “high cost carriers.” According to the ILECs, they experience higher costs not only because they serve challenging geographic areas, but also because they are below the

minimum efficient size to provide telecommunications services. The current structure of the industry causes the total cost to serve rural and high cost areas to be higher than necessary, resulting in a universal service fund that is much larger than it needs to be in order to meet the program objectives.

Second, the existing program mechanisms eliminate incentives that would otherwise be present. If permitted to operate, market forces would have created strong incentives for the ILECs to address these additional – and largely avoidable – sources of high costs. But because it is structured around a mechanism of reimburse the ILECs for the costs that they actually incur, rather than for the costs that would be efficiently incurred to serve rural areas, the existing program shields the ILECs from these market forces and has permitted them to continue to operate below the minimum efficient size of doing so.

Third, the existing mechanism provides for very little oversight of the use of funds by the ILECs. Most state regulators, as a part of the annual recertification process, closely monitor how CETCs use the support that they receive. In contrast, ILECs are subject to much less scrutiny, and are often allowed to simply self-certify that the support has been used only for the purposes intended. This disparity has been permitted even though both ILECs and CETCs must first invest in the network facilities to provide service in an area before receiving support.

The current proposals are premature and based on factually inaccurate assumptions.

By getting out in front of the essential comprehensive review and making specific proposals prior to its completion, the Joint Board and Commission have made a series of faulty assumptions that must be addressed as a part of the review process.

In its recommendation, the Joint Board proposes to define three categories of services, each supported by a separate fund: “mobility,” “broadband,” and “POLR.” The problem is that none of the three categories represents a “service” by any meaningful definition. “Mobility” is a capability included in the services provided by wireless carriers, “broadband” is a description of the capacity of the facility used by a provider to provision voice or data services, and “POLR” describes the historic treatment of one group of carriers that provides voice services. But none of the Joint Board’s three fund categories represents a service that can be purchased by customers. Instead, this proposed structure would serve to set the ILECs aside as a protected class of carriers and to significantly restrict support to any other type of provider. The three fund “solution” does not provide a means of achieving any stated objective of the program, but would instead create artificial constraints that would institutionalize existing inefficiency, restrict the service offerings available to customers in rural areas, and make the federal high cost fund much larger than necessary over the long term.

The Joint Board and Commission also fail to properly address the issue of service “substitution” by customers. The Commission improperly focuses on the question of how many rural customers have, to date, given up wireline service and instead opted to utilize wireless service exclusively. Such an approach ignores two critical facts: (1) wireline service was provided, and nearly universally adopted, before wireless service was made available, and (2) customers have never been required to choose between the two services as mutually exclusive offerings. The much more relevant question is “How many customers, if required to choose between wireline and wireless service, would choose to retain wireless service?” The answer to this more relevant question is likely to vary by geographic area, depending at least in part on whether a wireless carrier has been able to build out in the area to the degree necessary to provide quality service. Rather than attempt to determine rural customers’ current willingness to substitute one service for the other, the Commission can instead focus on developing a mechanism that will permit customers to make their own choice regarding the type and providers of the services that they need.

The current proposals don’t properly distinguish between actual program objectives and the means used historically to achieve them.

While pervasive in the current proposals and the language used to justify them, this means-end inversion is best illustrated by the proposal to eliminate the so-called “identical support rule.” The stated basis for eliminating this rule assumes that reimbursing carriers for the costs that they incur is an *objective* of the federal universal service program, rather than simply an historic means of

ensuring service availability in an environment in which only one carrier with a ubiquitous network existed. When evaluated in terms of whether it contributes to the actual objectives of the program, the “identical support rule” appears to be an effective means of both ensuring service availability and managing the size of the federal fund over the long run. The key to this analysis is to first distinguish between the actual objectives and the historic means to achieve them. Reaching the program’s objectives is a legitimate goal; perpetuating the historic means of doing so is not.

It is possible to address short-term issues while working toward a long term solution.

While the current proposals represent a step backward, options do exist for taking intermediate steps forward while taking the time to conduct the comprehensive review necessary to accomplish fundamental reform. Requiring the disaggregation of support, exercising greater scrutiny of the use of support by all ETCs, acting on the Commission’s previous decisions to base support on economic costs, implementing truly portable support, and capping support to all ETCs based on the costs of the most efficient provider all represent potential short-run options for increasing the efficiency of the program and reducing the size of the fund. As a longer term goal, true fundamental reform – reform that serves to achieve the objectives of the program without imposing costly artificial constraints – should be pursued. Fundamental reform, of course, begins with a comprehensive review. No shortcuts to this process have been identified.

Fundamental Flaws in the Current Process of Review of the Federal Universal Service Program

A review of the Joint Board Recommendation,¹ the Commission's NPRMs,² and the initial comments of the parties yields the following observations.

While a comprehensive review of the federal universal service program is needed, the parameters for a comprehensive review have not yet been established.

The Commission and Joint Board refer to a “comprehensive review” of the existing methods for distributing federal universal service support, and the Joint Board contemplates “fundamental revisions in the structure of the existing universal service mechanisms” based on its recommendations. Unfortunately, neither the Joint Board nor the Commission has articulated any parameters for such a comprehensive review, and neither has proposed or sought comment on anything that remotely resembles a set of “fundamental revisions.” Instead, various independent proposals have been advanced to address discrete elements of the program that are perceived, at least by some observers, to be a problem in need of a solution.

Such a piecemeal approach is fatally flawed. The truly comprehensive review needed to provide any legitimate basis for fundamental reform must, *ex vi termini*, include a review of all major elements of the program. In contrast, the

¹ Recommended Decision, FCC 07J-4, released November 20, 2007 (“*Joint Board Recommendation*”).

² Notice of Proposed Rulemaking, FCC 08-22, released January 29, 2008 (“*Joint Board Recommendation NPRM*”); Notice of Proposed Rulemaking, FCC 08-4, released January 29, 2008 (“*Identical Support Rule NPRM*”); and Notice of Proposed Rulemaking, FCC 08-5, released January 29, 2008 (“*Reverse Auctions NPRM*”).

current set of proposals is very narrow in scope and addresses only a limited number of individual elements. In addition, the merits of any given proposal must be evaluated in terms of how it would impact other elements of the program – and no framework for this essential broader examination has been laid. A “comprehensive” and “fundamental” reform is not simply the sum of the impacts of many piecemeal decisions, but must instead consist of a coordinated examination of all important elements of the program.

In order to conduct a meaningful evaluation of whether a proposed course of action will permit a set of objectives to be met, it is essential that those objectives first be defined.

In the current set of NPRMs, the Commission has omitted this essential first step and has instead jumped ahead to a consideration of several specific proposals. Setting forth a set of objectives as a basis for evaluating those proposals is essential for meaningful comment and consideration. It is not surprising that various parties have different opinions regarding whether a given proposal meets the objectives of the federal universal service program; the language of the comments suggests that these opinions differ in large part because each party has assumed (either explicitly or implicitly) that a set of objectives exist that are different from – and often inconsistent with – the objectives assumed to exist by other parties.

As the initial comments make painfully clear, any attempt to determine whether a given proposal is consistent with the objectives of the federal universal service program – without first reaching agreement on what those objectives are – is a resource-intensive but ultimately meaningless exercise.

Any review must be sufficiently broad so that the needed fundamental reform of all parts of the federal universal service program can be accomplished.

When considering any changes, whether limited to the narrow set of proposals currently being considered or a much broader, truly comprehensive reform, it is important to take note of the fact that no category of carriers alone, and no technology alone, represents the source of all of the current problems.³ Likewise, no category of carrier alone, and no technology alone, represents the necessary set of solutions. The Commission correctly established competitive neutrality as a universal service principle, but the debate about whether it should continue to be an explicit principle is ultimately moot: any meaningful attempt at comprehensive reform absolutely requires that *all* types of support to *all* types of carriers, using *all* types of technology to provide service, be fully examined. Setting aside any group of carriers (and the corresponding method of support), never considering whether the current method of support to that group is consistent with a set of program objectives, never considering how much that group of carriers contributes to any perceived problems for which solutions are now being proposed and considered – and then attempting “comprehensive” reform by considering only the remainder – is a fundamentally flawed process that cannot (by any process other than pure luck) result in good public policy.

Purpose of This Paper

³ This observation holds true whether the currently-perceived problems are imagined or real.

The purpose of this paper is to lay some essential groundwork so that a true comprehensive review can begin. The framework set forth here is only the beginning of the process, but represents an essential first step that cannot be omitted. Once a set of objectives has been fully considered and adopted, it will be necessary to develop a transition plan to move from the existing program to a mechanism that meets those objectives. The various proposals contained in the Joint Board recommendations, the Commission's NPRMs, and comments of the parties can then be evaluated in terms of whether they represent incremental steps toward – or steps away from – the agreed-upon objectives.

Where We Need to Go

Comprehensive reform that can lead to fundamental changes in the structure of the existing federal universal service program consists of three essential steps, each of which must be completed in order:

1. The adoption of specific and explicit objectives,
2. The development of a mechanism to meet those objectives, and
3. The development of a transition plan to move from the existing mechanism to the new.

An additional consideration is that truly “comprehensive” and “fundamental” reform does not impose artificial constraints on the mechanism adopted. Instead establishes the most effective and efficient mechanism possible to achieve the objectives of the program *and does so independently of how the existing program operates.*

Some Proposed Objectives for the Federal Universal Service Program.

The high-level objectives have been set forth by Congress in Section 254.

As the Commission points out

Section 254(b) of the Act, which was added by the 1996 Act, directs the Joint Board and the Commission to base policies for the preservation and advancement of universal service on several general principles, plus other principles that the Commission may establish. Among other things, there should be specific, predictable, and sufficient federal and state universal service support mechanisms; quality services should be available at just, reasonable, and affordable rates; and consumers in all regions of the nation should have access to telecommunications services that are reasonably comparable to those services provided in urban areas at reasonably comparable rates.⁴

Specific guidance regarding the means by which these high-level objectives should be met is limited, however. Section 254(e) of the Act limits support to ETCs, and requires any such support to be explicit and sufficient to achieve the purposes set forth above. Beyond these guidelines, the Act provides little in terms of defining a specific path forward. Beginning in 1996, the Joint Board and Commission developed the existing federal universal service program mechanisms, based on the available technology and prevailing market conditions at that time. Now, twelve years later, it is time to engage in the “fundamental reform” referenced in the *Joint Board Recommendation*. Doing so will require the development of new mechanisms based on the market conditions and available technology that exist today, and ideally mechanisms that can adapt to changes in technology and market conditions. It is essential, at this stage, to ensure that all

⁴ *Joint Board Recommendation NPRM*, ¶2.

elements of the program developed during a process of fundamental reform be designed to meet the objectives of the program, and *not* be designed to simply perpetuate the existing mechanisms found to be appropriate in the last century.

It is also important to take note of the fact that each of the high-level objectives set forth in the Act is stated in terms of what should be *available to customers* in high-cost areas: quality services at just reasonable, and affordable rates; and access to telecommunications services comparable to those services provided in urban areas, at reasonably comparable rates. *At no point does Congress mandate, or even suggest, that the federal universal service program should be designed to meet the needs of “high cost carriers.”*⁵ The objectives of Section 254 are stated in terms of services provided to customers in certain geographic areas. They are not stated in terms of the types of carriers that are to provide these services, and make no presumption that services will be provided using any particular technology.

Congress does state that in order for the stated objectives to be met, support should be “specific, predictable, and sufficient,” but does not suggest that this specific, predictable, and sufficient support should be targeted to any type of carrier. In fact, Section 254 does not state that this specific, predictable, and sufficient support need be targeted to carriers at all, but could instead be targeted directly to customers in high-cost areas. Going forward, continuing to provide support to carriers rather than directly to customers may prove to be the only administratively workable solution; but simply because support has historically

⁵ The importance of distinguishing “high cost carriers” from “carriers serving high cost areas” is addressed in a later section of this paper.

been administered in this way in no way suggests that supporting any type or category of carriers represents the *purpose* of the program.

In addition, the language of Section 254 does not fix the set of services to which customers in high-cost carriers should have access, beyond stating that these services should be “quality services” and that the scope of services available to customers in rural areas should be comparable to those available to customers in urban areas. This language fully contemplates that the scope of services needed and desired by customers in rural and high-cost areas will evolve over time.

Consistent with Act, the federal universal service program should focus squarely on customers, and not on any particular service providers. Any mechanism adopted for implementing Section 254 should meet the following objectives:

1. The program should be designed to be responsive to customer needs, and should not be designed based on the types of services that any group or category of carriers currently provides, or wants to provide.
2. The program should be designed, to the extent possible, to permit customers to express their desires and for the services supported by the program to evolve over time, ideally without direct intervention by regulators.
3. Consistent with the Act, the program should be technology neutral.⁶ Customers should be able to obtain the services they need, including services that may require a given underlying technology, and for their needs to continue to be met as they evolve and change over time.

⁶ Perhaps a better term for this concept is “technology agnostic”: that is, the mechanism should be indifferent to the underlying technology used to provide a service so long as the service includes all of the capabilities that customers in the targeted geographic areas need and want.

4. Consistent with the Act, the program should be neutral with regard to type or category of provider.⁷

5. The program should ensure service availability through a Provider Of Last Resort (“POLR”), but the identity of the POLR should be chosen by customers rather than established by the Commission. Because of their position as the “first in” providers, in many rural areas wireline ILECs may represent the only viable candidates to serve as a POLR in the immediate future. They should not, however, be presumed to be the POLRs into perpetuity, simply because they were first to enter the market using what was then the only available technology.

6. The program should encourage efficient investment and operation. Efficiency and low cost should be long term goals. Any mechanism adopted should not protect inefficient carriers any longer than is necessary to ensure POLR continuity.

7. The program should be structured to ensure these objectives are met while minimizing the size of the fund over the long term.

8. In order to ensure these objectives are met while minimizing the size of the fund over the long term, *the program must recognize a distinction between “high cost carriers” and “carriers serving high cost areas.”* The stated purpose of the federal universal service program is to ensure that customers in rural/high-cost areas have access to the services that they need and that are comparable to the services available in urban areas. In contrast, the purpose of the federal universal service program is *not* to ensure that a high-cost carrier, or indeed any given carrier, can recover its costs.

⁷ As with the underlying technology, the identity or type of carrier providing the service should not be a consideration, again so long as the service provided to customers meets the stated objectives of Section 254. As a result, “carrier agnostic” may be a more accurate description of the principle.

*Further Discussion of What is NOT a Proper Objective of the
Federal Universal Service Program.*

When defining a set of objectives, it is also important to clarify what is not a proper objective of the federal universal service program. Specifically, it is important to avoid having a part of the current mechanism that currently serves as a means to an end become elevated to an end in and of itself. Such an error in logic can lead to proposals and decisions that serve to perpetuate the existing mechanism, but do so at the expense of the true objectives of the program. A review of the *Joint Board Recommendation*, NPRMs, and subsequently filed comments strongly suggests that such an error of “means-end inversion” has taken place on a large scale.

Reimbursing carriers for expenditures in high-cost areas is not, and has never been, an objective or purpose of the federal universal service program.

The *purpose* of the program is to provide the funding necessary for the stated objectives of Section 254 – access to quality services for customers in rural and high-cost areas that are comparable to those services provided in urban areas, at reasonably comparable rates – to be met.

Historically, cost reimbursement has sometimes been used as a means employed to achieve this objective, but is not an objective *per se*. Prior to the introduction of competitive ETCs, only the services provided by ILECs were available in most rural areas. In order to ensure that these services remained available, support was provided through a number of implicit and explicit mechanisms. The method of determining the appropriate level of support for the explicit mechanisms was based on a measure of the costs incurred by the ILEC

to serve a given area.⁸ But while the method used to establish the level of support was based on ILEC costs, the *purpose* of the program was not to reimburse the ILEC for costs that it incurred; the *purpose* of the program was to provide the level of support necessary for the objectives of service availability and affordability to be met.

In their comments, the ILECs address the recovery of their costs as if this recovery were an inalienable right. In fact, they have taken this claim a step further to insist that the recovery of embedded costs is such a right, even though the Commission has been clear that support based on economic costs represents a superior public policy solution.⁹ Unfortunately, the Commission's implementation of this policy appears to have fallen by the wayside, emboldening the ILECs to claim the right to life, liberty, and the recovery of embedded costs. But the ILECs are just wrong about this: pursuant to the Act it is *customers* who have rights (the right to quality, affordable services with capabilities comparable to those available in urban areas); but no carrier – even one that has historically operated as a POLR – is endowed with the right to recover its costs.

This critical distinction has become utterly lost in the current debate. The relevant question is not, and has never been, “How do we develop a mechanism

⁸ Over time implicit subsidies, such as those found in various forms of access charges, have been made explicit. These now-explicit rate elements have been treated as if they represent a form of cost recovery, but no analysis has been conducted in order to determine whether this implicit-to-explicit support represents cost recovery or simply revenue replacement.

⁹ As early as 1996 (and affirmed in 2001), the Commission concluded that “support based on forward-looking cost is sufficient for the provision of the supported services and sends the correct signals for entry, investment, and innovation.” In 2001, the FCC gave the ILECs notice that after a five year transition period, support would be based on forward-looking cost, but never acted to implement this change (Fourteenth Report and Order, FCC 01-157, released May 23, 2001, ¶174, including footnote 406).

that will allow carriers to recover their costs?” but rather “How do we develop a mechanism that will provide sufficient funding in a given area for the objectives of Section 254 to be met?” Historically, with only wireline technology available and with only an ILEC providing service in an area, it was concluded that a workable method of providing sufficient funding was to permit the ILECs to recover some measure of their costs. Cost recovery was the method used to develop a first approximation of a sufficient level of support, and that support provided the means for the objectives to be met.¹⁰ In the current debate, cost recovery has been elevated from simply one of several available methods for ensuring a sufficient level of support all the way up to a fundamental objective of the federal universal service program. Unfortunately, this promotion is never explicitly recognized or addressed in the *Joint Board Recommendation* or subsequent NPRMs, but rather is treated as a given with no explanation. This provides no opportunity for examination or debate regarding whether it is sound public policy to elevate one of a number of potential means for reaching an end to the level of an end in itself. Certainly the development of sound public policy requires that a decision to do so, and the rationale supporting it, be fully examined before being implemented.

This means-end inversion has now caused questions to be framed in a way that is ultimately meaningless. For example, the Joint Board and

¹⁰ It should be noted that the services supported via this mechanism meet the pre-1996 objective of some minimal service offering provided at an affordable rate, but are not consistent with the stated objective of section 254 of “access to telecommunications services comparable to those services provided in urban areas, at reasonably comparable rates,” because ILEC offerings are limited in scope and alone are not comparable to the range of services available to customers in urban areas.

Commission now question whether the so-called “identical support rule” should be eliminated because it results in an amount of support available to CETCs that may not accurately reflect the CETC’s costs of serving an area. In effect, the Joint Board and Commission are seeking to address the question “How do we develop a mechanism that will permit a CETC to recover “its own costs of providing the supported services?” but are doing so without first explicitly considering whether cost recovery is in fact the actual objective. When cost recovery is considered in its proper context – solely as a mechanism used historically to approximate the level of support required for a given geographic area – it becomes clear that the relevant question is instead “How do we develop a mechanism to determine the level of support needed in a given area, so that the objectives of Section 254 will be met?” This is a fundamentally different question that may or may not include any calculation of carrier costs as a part of its answer.

The Commission does begin to address this broader question in the *Reverse Auctions NPRM*, in which it considers methods for establishing the level of support that are potentially independent of any measure of cost. The problem is that the logical bases of the *Identical Support Rule NPRM* and the *Reverse Auctions NPRM* are mutually exclusive: in the *Identical Support Rule NPRM*, the Commission assumes that a cost basis is the proper measure of whether the existing mechanism should continue to be used, and tentatively concludes that the “identical support rule” should be eliminated because it does not result in support that is reflective of the CETC’s “own costs.” In the *Reverse Auctions*

NPRM, the Commission reaches a tentative conclusion that auctions “offer several potential advantages over the current high-cost support distribution mechanisms,” in part because it is a “market based approach” that does not rely on a measure of cost. The de-linking of support from carrier costs cannot be touted as a worthy goal of a new proposed mechanism, yet simultaneously offered as the reason for eliminating one provision of the current mechanism.

Treating cost reimbursement as an objective, rather than an historic means of meeting the actual objectives of the federal universal service program, has led to a fundamentally flawed proposal and to a set of arguments that border on the surreal. As described above, the Commission has reached a tentative conclusion that the “identical support rule” should be eliminated because the level of support is not representative of the costs incurred by CETCs. In other words, the level of support created by the “identical support rule” is considered to be inappropriate because it does not properly reimburse a CETC for the costs that it incurs to serve a given area. The merits of the “identical support rule” – like *all* elements of the mechanisms currently in place – should be carefully and thoroughly reviewed as a part of any “comprehensive review” that can lead to “fundamental reform.” *But simply noting that the “identical support rule” does not accurately reimburse CETCs for their costs says nothing about whether the “identical support rule” is consistent or inconsistent with the objectives of the federal universal service program.*¹¹ The Commission’s tentative conclusion, therefore, is premature for at least two reasons: it has been reached outside of

¹¹ Attributes of the “identical support rule” are addressed in more detail in a later section of this paper.

the context of a true comprehensive review of all elements of the federal universal service program, and the primary assumption supporting the tentative conclusion – namely, that an appropriate level of support must be based on a given carrier's cost to serve an area – has no foundation in history or fact. The Commission may ultimately conclude, after gathering all of the evidence necessary, that the “identical support rule” should be eliminated, or it may conclude that the “identical support rule” represents an integral part of the transition toward a set of long-term objectives. At this point, however, there is insufficient evidence for any informed decision regarding the merits of any significant change to the existing mechanism, including but not limited to the Commission's tentative conclusion to eliminate the “identical support rule.”

Treating cost reimbursement as an objective has also created an incentive for ILECs to make the frankly bizarre argument that they alone should be supported because they are the least efficient, highest-cost providers of services in rural areas. In no other context do the providers of a service proudly and with righteous indignation proclaim to regulators that they have higher costs than their potential competitors, or insist that potential competitors be penalized for being more efficient or for using a more modern and often more efficient technology.

After arguing that they should be entitled to embedded cost recovery because they have the higher cost, and that CETCs should receive a lower amount of support (if any) because they have lower costs, the ILECs go on to argue for limits on support to CETCs because of concerns regarding the size of the federal high cost fund. This statement is worth repeating, because it lies at

the heart of the matter now being considered: *The ILECs are arguing that in order to manage the size of the federal fund, support to the higher cost carriers should be maintained indefinitely, while support to lower cost carriers should be reduced or eliminated.* At no point do the ILECs explain why a plan to encourage network buildout by lower cost carriers, so that supporting the higher-cost carriers would not longer be necessary, would not represent a better and more effective approach.

The Joint Board in its recent recommendations, and the Commission in its NPRMs, fall victim to this perverse logic. But these two conflicting positions cannot be reconciled: it is possible to provide a higher level of support to ILECs because their costs are higher (and lower level of support to CETCs because their costs are lower),¹² or it possible to pursue a goal of minimizing the amount of universal service support required to meet the program's objectives,¹³ *but it impossible to pursue both of these objectives at the same time.*

Assigning the issues to separate NPRMs does not resolve the inherent conflict in these two positions. In the *Reverse Auctions NPRM* (§4), the Commission observes that "in February 2007, the Joint Board held an en banc hearing to discuss high-cost universal service support in rural areas, including the use of reverse auctions to determine support. In his opening remarks, Chairman Kevin Martin explained that 'reverse auctions could provide a

¹² "We therefore tentatively conclude that the goal of universal service will be better served if we eliminate the identical support rule and instead provide support based on the competitive ETC's own costs" (*Identical Support Rule NPRM*, ¶12).

¹³ "By encouraging more efficient carriers to submit bids reflecting their lower costs, another advantage of a properly structured bidding system would be its ability to reduce the amount of support needed for universal service" (*Reverse Auctions NPRM*, ¶3).

technologically and competitively neutral means of *controlling fund growth* and *ensuring a move to most efficient technology over time*” (emphasis added). Controlling fund growth and ensuring a move to the most efficient technology over time are worthy objectives, but neither can be met while simultaneously setting aside the ILECs as a protected class of carrier to be insulated from competitive pressures and from the consequences of their own inefficiency.

Maintaining the rural ILECs as POLRs is not an objective or purpose of the federal universal service program.

The mantra that has been used to equate the interests of the rural ILECs with the interests of customers is neatly summarized in an OPASTCO white paper:

Rural incumbent LECs are the only providers of ubiquitous, high-quality facilities-based telecommunications service throughout their respective service areas. For these carriers, universal service support has always been, and continues to be, a critical means of *genuine cost recovery* that has made the provision of modern, affordable service possible in high-cost areas. Thus, if rural ILECs lose the ability or incentive to continue investing in their networks – or worse yet, if their existence is placed at risk – then some rural areas may be deprived of basic universal service (emphasis in original).¹⁴

Over the years, this message has been both consistent and persistent: only rural ILECs provide ubiquitous service, the “true” purpose of universal service support is to permit ILEC cost recovery, and if this cost recovery is threatened, people living in rural areas will lose their only source of telephone

¹⁴ *Universal Service in Rural America: A Congressional Mandate at Risk*, prepared by the Organization for the Promotion and Advancement of Small Telecommunications Companies, January 2003, p. 3.

service. Acceptance of this argument has led to a mindset of ILEC protection = customer protection. Of course, if any link in this chain of assumptions can be shown to have always been invalid or to now be invalid based on currently-available information, public policy decisions will be directly impacted. Any serious attempt to conduct a “comprehensive review” of the existing federal universal service program *must* include an examination of the veracity of each of these assumptions.

As an initial matter, any focus on the protection of carriers, rather than on the interests of customers, is misplaced. The interests of individual carriers, or categories of carriers, should not be part of the public interest determination, unless it can be demonstrated that the carrier (or category of carriers) in question represents only potential POLR in a given geographic area, both now and forever more. Absent such a demonstration, the focus must be on the most effective and efficient means of meeting the needs of customers, even if this means that a carrier, or category of carriers, plays a less prominent role in meeting these needs in the future than it has in the past.

In its previous orders, the Commission has been clear, as the courts have been clear, that the purpose of the federal universal service program is to protect rural consumers of telecommunications services rather than to protect the ILECs:

The Act does *not* guarantee all local telephone service providers a sufficient return on investment; quite the contrary, it is intended to introduce competition into the market. Competition necessarily brings the risk that some telephone service providers will be unable to compete. The Act only promises universal service, and that is a goal that requires sufficient funding of *customers*, not *providers*. So

long as there is sufficient and competitively neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well (emphasis in original).¹⁵

As addressed in further detail below, the Joint Board's recommendation to set the ILECs aside as a special protected class of carrier by establishing a "POLR Fund" containing the majority of available support, to which they alone would have access, turns this basic principle on its head.

The second important consideration is that market conditions and available technology have changed since the current federal universal service program was first put into place, and can be expected to continue to change going forward. Wireline ILECs may have previously been the only carriers with ubiquitous coverage in most rural areas, but this may no longer be true in some rural areas and certainly will not continue to be true in most or all rural areas if CETCs are able to fully build out their networks. Once a second ubiquitous network is constructed, a threshold point is reached: the need to preserve the ILECs – the self-proclaimed high cost providers of services in rural areas – will be eliminated, enabling the Commission to move to one of several alternatives for "controlling fund growth and ensuring a move to the most efficient technology over time." But the inescapable consequence of limiting the support available to CETCs (and particularly of making a significant reduction in the amount of support available to CETCs the centerpiece of the current reform efforts) is that

¹⁵ *Alenco Communications, Inc. v. FCC*, 201 F.3d at 620, cited in *Fourteenth Report and Order* at ¶ 27.

the arrival of this threshold point – in which a second ubiquitous network becomes operational and effective mechanisms to “control fund growth” and to support only the “most efficient technology” can be implemented – is inevitably and significantly delayed.

Finally, it is essential to remain mindful that cost recovery has always been a means to an end; in this case, that end has been to keep a carrier, even a high cost carrier, operational in order to ensure the availability of services in a given geographic area. But cost recovery is not the objective, and if a potential POLR with lower costs is able to fully build out its network in a high cost area, there is no public policy reason to continue to permit a self-proclaimed inefficient provider to experience “genuine cost recovery.”

The Joint Board’s recommendation to perpetuate the existing level of ILEC support by creating a protected class of carriers, and making the majority of federal universal service program support available only to members of that protected class, supports no legitimate public policy objectives and is fundamentally flawed for several reasons.

In its recommendation, the Joint Board explains that “a Provider of Last Resort (POLR) Fund would support wireline carriers who provide this function.”¹⁶ Such a statement is based on several implicit, yet extremely important assumptions. First, the Joint Board is assuming that only wireline carriers can provide a POLR function and that only wireline carriers will be able to provide this function in any foreseeable future. Second, the Joint Board is assuming that

¹⁶ *Joint Board Recommendation*, ¶11.

sound public policy supports a position that the existing ILECs should be treated as the presumptive providers of this function both now and into perpetuity. Third, the Joint Board is assuming support to ensure embedded cost recovery is the only means of ensuring the continued operation of those POLRs. None of these critical assumptions is subjected to rigorous examination by the Joint Board (in fact, the recommendation fails to address these critical assumptions at all) before reaching its conclusion that such a class of protected carriers should be created. Fourth, and perhaps most importantly, the Joint Board appears to have lost sight of the fact that it is the concept of a POLR, and not the carriers currently acting as POLRs, that is to be protected: “So long as there is sufficient and competitively neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider.”

The Joint Board goes on to articulate its belief that “it is no longer in the public interest to use federal universal service support to subsidize competition and build out duplicate networks in high-cost areas.”¹⁷ The Joint Board is missing a fundamental point here: if the ILECs are indeed the higher-cost providers that they claim to be, and if the objective is to minimize the size of the fund over the long term, *then the construction of a “duplicate network” in rural*

¹⁷ *Joint Board Recommendation*, ¶35. It is important to note that references to “duplicate networks” have been made to two factually distinct circumstances that should be distinguished. In the first instance, the phrase is used to describe the construction of a second ubiquitous network in a given area; that is, the ILEC network and a second network. In the second instance, the phrase “duplicate networks” has been used to described the perception (albeit a false one) that the existing federal universal service program mechanism encourages in the construction of multiple (and therefore duplicative) CETC networks in a given area.

areas should be the first priority reflected in any “fundamental reform” of the program.

A more abstract example can help to put the current debate into better perspective. A company that builds widgets may have previously constructed a factory based on the most efficient technology available at that time. Decades later, the company may be able to construct a new factory, using a newly-available technology, that can be used to construct widgets with additional features and at a lower cost. If the company is seeking to minimize its production costs over the long term, it will not refuse to invest in the new factory because it would be a “duplicate” of the existing factory, but instead would go forward with the investment because the new factory represents a lower cost means of maintaining the needed production capacity. Similarly, a manager who argues that the company’s available capital should be not be used to invest in the lower cost technology, but should instead continue to be used to support the existing factory *because* of the existing factory’s higher costs, would be unlikely to advance very far. Finally, an executive committee that recommends setting aside the existing factory as a protected class of company asset, to be kept in service into perpetuity regardless of the cost of operating it simply because it was the first factory constructed by the company and therefore represents the only *currently available* means of producing the required number of widgets,¹⁸ would

¹⁸ Presumably, their argument would be that as the only existing facility with the ready capacity to meet all of the company’s demand for widgets, the original production facility represents a Factory of Last Resort (FOLR) that must be forever kept in service. A reasonable response to such a claim might be that if the company’s objective is to meet the demands of customers, it would be rational to keep the existing factory in service *only* until the new factory is fully

be unlikely to receive a warm reception from the board of directors or the company's investors.

The Joint Board next seeks to justify its proposal to create a protected class for ILECs by noting that the ILECs “have done a commendable job of providing voice and broadband services to their subscribers.”¹⁹ While this observation alone provides no tangible support for the proposal, it does bring to light two relevant issues that warrant further discussion.

First, as a group of carriers who have received billions in implicit and explicit subsidies, it is certainly reasonable to expect the ILECs to have done nothing less than a “commendable” job of providing basic voice services. Unfortunately, the Joint Board offers no explanation why it believes that meeting this minimum standard entitles the ILECs to be protected as the only carriers who could possibly be commended for providing such services in the future. Surely it is possible to admit that other carriers, using other technologies, could provide these services at a level of quality and at a price that is equally commendable. If so, the Joint Board's proposal to reserve the majority of available support for the ILECs represents an artificial constraint that limits the service options to customers, further institutionalizes inefficiency and high costs, and makes the federal fund larger, over the long run, than it needs to be in order to meet the objectives of the program.

operational. Going forward, the operation of this “duplicate” factory would enable the company to fully meet customer demands while minimizing its costs over the long run.

¹⁹ *Joint Board Recommendation*, ¶39.

Second, while providing broadband services in rural areas is a worthwhile public policy goal that should constitute a central component of any “fundamental reform” of the program, the means by which the ILECs have invested in the facilities needed to do a “commendable job” of providing these services warrants closer scrutiny. As the ILECs consistently point out when intervening in state reviews of CETC designation applications, their networks are, and in most cases have been for a considerable length of time, fully built out to all customer locations.²⁰ Some additional investment has been required over time as new residence and business locations are constructed, but the ILECs have not been shy about proclaiming the ability of their existing networks to reach all, or nearly all, customer locations. A question should arise regarding how ILECs have used the ongoing flow of high cost support. Investments in broadband facilities in rural areas, while otherwise commendable, are beyond the scope of the existing program: “broadband” is not one of the nine supported service functionalities set forth in 47 CFR §54.101. Rather than simply commending the ILECs for providing broadband services, it would be reasonable for the Joint Board and Commission, as a part of a “comprehensive review” that can lead to “fundamental reform,” to investigate how the ILECs have used the support that they have received.²¹

²⁰ From a public policy standpoint, it is important to recognize that a “ubiquitous” wireline network provides service to all fixed customer locations, but provides no service at all beyond those locations. In contrast, a “ubiquitous” wireless network has the potential to provide service not only to all fixed customer locations but also at other locations where a customer may need service.

²¹ An argument that such an investigation is unnecessary because ILECs receive support “only for costs actually incurred” cannot be persuasive here. Assuming that the ILECs’ claims that

An attempt could be made to justify an ILEC's use of support in order to invest in broadband facilities through an observation that while the support was used for purposes other than providing the nine supported service functionalities, it was nevertheless used for a worthwhile purpose so that a commendation is still in order. Such an argument must fail for at least two reasons.

First, an approach that permits one class of carriers to operate pursuant to an unwritten "for the intended use or some other worthwhile purpose" is (1) not consistent with the language of the existing regulations, (2) vague to the point that it invites abuse, and (3) certainly not an effective means of minimizing the size of the fund over the long term.

Second, it is difficult to conclude that the creation of a protected class of carriers with sole access to the majority of support, to be locked away in a "POLR Fund," can be justified on an assumption that such an approach is the best means available to expand broadband capability in rural areas. As an initial matter, it is unclear why, if broadband investment in rural areas is to be accomplished through a process of reserving the majority of support for the ILECs to provide basic telephone service and then looking the other way regarding how the support is actually spent, the Joint Board seeks to establish a separate Broadband Fund with its own requirements and qualifications. This approach also represents a digression from the objective (and statutory requirement) to make support explicit; it is unclear why, if an ILEC seeks support to invest in broadband facilities under the Joint Board's proposal, that it could not

these (largely unaudited and unreviewed) costs were actually incurred, the salient still question remains: Actually incurred in order to do what?

seek explicit support from a separate fund established for that purpose. Finally, such an approach certainly represents a digression from the objective (and statutory requirement) to make support portable; under the Joint Board's proposal, the majority of the support expected to be used for investments in broadband facilities in rural areas would be set aside for the ILECs, with only the relatively small amount of support transferred to the Broadband Fund actually available to other carriers – even if these other carriers can demonstrate an ability to provide broadband functionality more efficiently and at a lower cost than the ILEC.

Finally, the Joint Board recommends that “the POLR Fund provide support for only one carrier in any geographic area,” and notes that “initially this will be an incumbent LEC providing voice service over traditional landline facilities.”²² A closer examination of this statement reveals additional problems with the Joint Board proposal.

First, the Joint Board simply states that initially the supported carrier “in each of the existing incumbent LEC study areas” will be the incumbent LEC, but offers no further basis for such a fundamental conclusion. It is likely to be true in many rural areas today that the wireline ILEC represents the only currently-ubiquitous network,²³ but certainly this not universally true. In areas where a second ubiquitous network is already in operation, there is no reason to simply coronate the ILEC as the presumptive POLR (for which the majority of available

²² *Joint Board Recommendation*, ¶43.

²³ As explained above, “ubiquitous” as used in this context refers to a wireline carrier’s ability to serve all fixed customer locations (i.e., existing homes and businesses). In contrast, a wireless carrier has the potential to offer a service that is truly “ubiquitous” in terms of all potential locations where a customer might need to use the service.

support is reserved), and the Joint Board offers to basis for its conclusion that the interests of the public are best served by doing so.

Second, reserving the majority of support for the ILECs will unavoidably delay the construction of a second ubiquitous network in any given geographic area. As a result, the “initial” period during which the Joint Board assumes that ILECs will serve as the only POLRs is likely to last for a very long time. By freezing current conditions, the Joint Board proposal would limit the service options available to customers, protect high cost carriers from competitive pressures, and cause the fund to be larger than necessary over the long run.

The question of whether the ILECs should be treated as the presumptive POLRs both now and in any foreseeable future, and therefore whether the most recently proposed form of “carrier protection” is at least arguably equivalent to “customer protection,” lies at the heart of this issue. As the only carriers then with networks in place to serve rural areas (or at least to serve most of the fixed customer locations in rural areas), ILECs have historically been treated as sacrosanct and the federal universal service program mechanism has focused on their protection. But such an approach cannot be justified if another carrier is able to build out a ubiquitous network in the area.²⁴ Rural ILECs have consistently opposed the designation of additional carriers (and particularly wireless carriers) as ETCs. Their opposition is nearly always some variation of (1) an argument that the rural ILECs alone are the guardians charged with

²⁴ Any possible justification is further nullified if another carrier has the potential to construct a network with “true ubiquity,” that is, the ability to provide service in all or most of the entire geographic area, rather than only at fixed customer locations.

preserving the sanctity of the fund, or (2) an assertion that the very viability of the federal high-cost fund is at stake, that as a result the viability of the ILECs – as the historic POLRs in rural areas – is at stake, and therefore that the ability of many customers to receive basic telephone service is at stake. But the true motivation for their opposition to the designation of wireless carriers as ETC has become clear: if another carrier can build out to serve the area, then it will be possible to fully protect customers without protecting the ILECs (who are, after all, the self-proclaimed high cost providers of service in these areas). Once a lower cost ubiquitous network is in place and operational throughout the area they serve, ILECs will find themselves in the awkward position of guests who have overstayed their welcome at the party.

A mechanism to meet these objectives must be developed.

Once a set of objectives has been developed and articulated in a way that segregates the true objectives from the means currently used to attain them, the next task will be to develop a new mechanism that will effectively and efficiently meet the stated objectives. While a mechanism that represents true “fundamental reform” will require additional input and development, the following criteria should be used as a framework for that development.

The new federal universal service program mechanism should rely on a combination of regulations and market forces to achieve the desired outcome. A well-designed mechanism will provide the correct incentives for carriers to provide quality services, provide service over the widest possible geographic area, and to operate as efficiently as possible. Although they are decidedly

premature at this stage,²⁵ some variation of the current auction-based proposals may represent a potential candidate to provide the correct incentives.

The new federal universal service program mechanism will allow customers to express their needs – and changes in those needs over time – through market activity so that the Commission does not have to periodically redefine what customers “ought to want.” Once the focus moves away from protecting one group of carriers and toward protecting rural customers directly, it will be possible to permit these customers to have a much more direct impact on the nature of the program. By making the selections among services, carriers, and technologies that *they* want, customers will have a direct role in determining which carriers receive support and potentially which carriers continue to operate in a given area.

In contrast, the existing mechanism is based on a regulator-determined list of “essential” supported service functionalities. The list is based on the market conditions and available technology that were present at a previous point in time, and has remained static even though both market conditions and available technologies have undergone significant changes. The new federal universal service program mechanism should replace, to the extent possible, this process of having regulators attempt to determine what customers will want and need over an extended period of time with a market-based approach that will allow customers to make these choices and give them the ability to have their needs

²⁵ Until a second ubiquitous network is in place, an auction for a given geographic area is a meaningless exercise. Once a second network is in place, it will be possible to implement “a competitively neutral means of controlling fund growth and ensuring a move to most efficient technology over time.”

continue to be met as they change over time. The current (and now-proposed future) paradigm of protecting ILECs instead of customers suffers from two inherent limitations: (1) it locks in the list of supported services with no opportunity for customers to change them as their needs change, and (2) it limits the list of supported services to those that can be provided using the ILECs' wireline technology, even though customer needs continue to evolve and have begun to require capabilities that a wireline network cannot provide.

The new federal universal service program mechanism should keep protections in place to ensure service availability where only one carrier can currently provide service, but in doing so (1) should not delay the deployment of a second network and (2) these protections should be maintained only as long as necessary. Ensuring service availability and encouraging the rapid buildout of a second ubiquitous network are not mutually exclusive objectives; in fact, both must be pursued now in order to manage both the effectiveness and size of the fund over the long term. Once a second ubiquitous network is in place in a given geographic area, the focus of the program should be squarely on customers rather than on protecting any carrier.

Whatever the details of the new federal universal service program turn out to be, it must be based on a mechanism for meeting the identified objectives of the program. Conversely, it must not become simply an attempt to artificially maintain the historic structure of the industry or to artificially perpetuate a historic universal service support mechanism found to be appropriate in the past.

A transition plan must be developed.

It would be poor public policy to press forward with the piecemeal approach now being contemplated in the Commission's NPRMs without first conducting a comprehensive review that can actually lead to fundamental reform. Blindly charging forward in this manner offers no assurance of success (or even any reasonable expectation of success) and carries with it the very real possibility of making matters worse by moving away from the long term objectives of the program. The price of acting prematurely and before the necessary comprehensive review could be a significant delay and lengthening of the necessary transition to a new, effective mechanism. And of course, it would not be a meaningful exercise to attempt to develop a transition plan without first having a fully developed set of goals and objectives in mind. Put simply, before we can figure out how to best get from "here" to "there," it is first necessary to know where "there" is. Without a complete understanding of the desired destination, taking steps now – simply for the sake of taking steps in some direction – is just as likely to represent movement away from the desired destination as toward it.

Once the objectives are identified and a new mechanism for meeting those objectives has been fully developed, sufficient information will be available to plot the best path from "here" to "there." In addition to a firm grasp of the intended destination, some additional factors should be considered when developing a transition plan, but the overarching goal should be to move as directly as possible to the new mechanism without undue delay.

The first step of the transition should attempt to address existing concerns, though two caveats are in order. First, to be a legitimate consideration, any stated concern should reflect a limitation in the ability of the needs of customers to be met. In contrast, a stated concern may be genuine but reflect a desire to artificially maintain the *status quo* regarding the structure of the industry or the technology used to provide service.²⁶ This second category of concern should not represent a constraint to be considered when developing a transition plan.

Second, concerns should be addressed only to the extent that they have been demonstrated to exist. Various dire predictions may be offered up as the rationale for limiting support to some carriers or for guaranteeing support to other carriers, but it is important to be mindful that dire predictions are nothing new in this industry (or even in this specific context), and few have proven to have any real merit. Carriers whose self interests have historically been well served by the current federal universal service program mechanism can be expected to offer predictions of certain doom if the program or the industry is permitted to change (in reality, these arguments often go further and warn of catastrophic consequences if the clock is not turned back to restore circumstances as they existed, or are perceived to have existed, in decades past). But any transition path that is adopted should represent the most direct route from where we are today to the full implementation of fundamental reform, and should deviate from

²⁶ For example, a concern regarding the ability of customers in a given geographic area to receive the services that they need is a legitimate consideration when developing a transition plan. A concern that those customers may prefer the service offered by a new provider over the service offered by the historic provider – even if the expression of that customer preference puts the viability of the historic provider in doubt – is not a legitimate consideration when developing a transition plan.

that direct path only if it can be demonstrated that such a deviation – and the corresponding delay – is fully justified.

Finally, it is critical to keep in mind that any time, *such as the present*, when the final objectives and new mechanism of “fundamental reform” are as yet unknown, “action for the sake of action” is a highly risky act that carries the risk of significant long term harm to the objectives of the federal universal service program and to customers. In the *Joint Board Recommendation* and the Commission’s NPRMs, several proposals have been made that represent steps in a more-or-less random direction in what – until a comprehensive review has actually taken place – is a dark and featureless landscape.²⁷ Circumstances can arise that justify a decisive step in a random direction in such dark and uncertain circumstances (the sound of a bear behind you, perhaps), even though that step may represent a movement toward safety, to a position of equal safety and risk, or directly off the cliff. But while the current circumstances have been described in dramatic terms (the high-cost fund is in “dire jeopardy” of “imminent collapse,” for example), no party has demonstrated, or has even attempted to demonstrate, the presence of an actual bear. Without knowing whether the sound is indeed a bear or merely the echo of a party whose interests are served by crying wolf, it makes no sense to take such a risky step in the dark, yet several such steps have been proposed.

²⁷ This landscape is not inherently dark; a truly comprehensive review of the program could serve to illuminate the area, making it much more clear whether a step now being contemplated represents a step toward safety, away from safety, or into the abyss.

Given the existing level of uncertainty, and without the results of a comprehensive review that could eliminate much of that uncertainty, the only prudent course of action is to adopt a policy of *primum non nocere* until the necessary comprehensive review of the existing federal universal service program has taken place.

Some prudent action may be possible before a comprehensive review has been completed, but only in a specific set of circumstances. If a range of possible desired outcomes is known, even though the specific outcome has yet to be determined, an action can be undertaken²⁸ if doing represents a positive step on the transition path from the existing circumstances to any of the outcomes in the range. For example, the Commission may conclude that some yet-to-be-defined form of auction represents a “technologically and competitively neutral means of controlling fund growth and ensuring a move to most efficient technology over time,” but may not have reached a determination regarding the specific details of such an auction process (and may not reach such a final determination for some period of time). As described previously, the construction of a second ubiquitous network is an essential prerequisite to any meaningful auction process. It may be prudent, therefore, for the Commission to undertake an action that will encourage and facilitate the construction of this second network, because doing so represents a positive step along the transition path

²⁸ A decision to undertake such an action may represent a decision to implement changes, or it may represent a decision to make no change to a given element of the program.

from the current circumstances toward a wide range of possible future objectives.²⁹

A Survey of Where We Are, Including Some Uncomfortable Truths That Must Be Confronted

The Collection of Uncomfortable Truths, Part 1: The incentives created by the existing federal universal service program have resulted in a highly inefficient structure for providing services to rural and high cost areas.

The recognition of this undeniable truth in no way requires, or even suggests, a conclusion that the ILECs have acted in any way other than within the applicable regulations. Similarly, such recognition in no way requires a conclusion that regulators have acted in a way that has created the current circumstances (or have failed to act in a way that could have prevented them). In reality, if the objective at hand is to begin to undertake a comprehensive review that can lead to fundamental reform, there is absolutely nothing to be gained by attempting to assign responsibility for the present circumstances.

What now must be confronted is the following inescapable fact: If presented with the question “How could we effectively and efficiently provide the telecommunications services needed by customers in rural areas?,” no rational person would respond with any of the following – “with the current number of independent rural ILECs,” “with the existing service area sizes of the current number of independent rural ILECs, or “predominantly with the technology used by the independent rural ILECs.”

²⁹ A subsequent section of this paper addresses the existing mechanism, including the oft-maligned “identical support rule,” with specific consideration of whether the existing mechanism represents such a positive step in a transition to a wide range of possible objectives.

The existing method of serving these areas evolved over several decades and is a direct function of historically-available technology and the interest (or more accurately, lack of interest) of larger carriers in serving rural and other high-cost areas. To be sure, the ILECs serving many rural areas have made considerable contributions to the past economic development of the area they serve, and (while receiving a series of implicit and later explicit subsidies) have provided service in areas where no other provider was willing or able to do so. Facts related to the past performance of rural ILECs are not in dispute here because they are fully outside the scope of the questions now before us. As both the Commission and the courts have consistently pointed out, the objective of the federal universal service program is to protect customers, not carriers. Yet the unstated presumption in the *Joint Board Recommendation* and the NPRMs is that the protection of existing carriers is paramount, and this presumption leads to the recommendation of proposals that seek to preserve the previous *method* of providing service in rural areas (that is, by protecting the ILECs) rather than considering the most effective and efficient way to serve and protect the customers themselves.

The implications of this presumption underscore the need for a truly comprehensive review: a review that evaluates ways to ensure that the needs of customers are met, and that is not artificially constrained by the methods previously employed to do so. In short, the existing proposals completely fail to consider whether “what has been done” has anything in common with “what should be done.” Instead, the Joint Board and Commission have bypassed any

consideration at all of “what should be done,” and instead have gone directly to proposals designed to protect and preserve “what has been done.” This approach is certainly beneficial to the group of carriers who were protected under the “what has been done” mechanism, but it in no way addresses the fundamental question of whether doing so is in the best interest of the people who live and work in rural areas.

There is no disagreement regarding the fact that many of the rural and high cost areas of the country today are served by a very large number of very small carriers, and that these carriers are properly characterized as “high cost carriers.” To even begin to undertake a meaningful review (comprehensive or otherwise) of the current situation, a threshold question must be addressed: Do the ILECs incur higher costs *only* because of the characteristics of the geographic areas that they serve, or do they incur higher costs for other reasons? The answer to this question has broad public policy implications, and must be at the center of any consideration of “fundamental reform.” If the ILECs unavoidably incur high costs solely because of the areas that they serve, then this fact must be considered when developing any new universal service mechanism. If, however, the ILECs incur higher costs for additional reasons, including some that are ultimately avoidable, then this fact must also be considered, though the public policy implications are fundamentally different. Providing a certain level of support to a carrier because it unavoidably incurs higher costs as a result of the challenging characteristics of the area it serves is

one matter, but providing a level of support to a carrier because it incurs higher costs that are ultimately avoidable is another matter entirely.

Unfortunately, the existing federal universal service program mechanism, and the proposals of the Joint Board and Commission that will serve to perpetuate that mechanism, completely fail to make the critical distinction between “high cost carriers” and “carriers serving high cost areas.” Setting aside the issues related to the portability and precise level of support, as a general matter customers can benefit if a carrier receives support so that it can provide service in an area that is otherwise too costly to serve at a reasonable price. In direct contrast, there is no customer benefit if a carrier receives additional support because it experiences higher costs for reasons other than those directly related to the characteristics of the area being served.³⁰

Given the public policy implications of this issue, it seems reasonable that a complete examination of the distinction between “high cost carriers” and “carriers serving high cost areas” would be one of the first tasks undertaken in a comprehensive review of the existing federal universal service program. Yet both the Joint Board and the Commission sidestep this issue, deftly equating “high cost carrier” to “high cost area” in some contexts, while acknowledging in other contexts that ILECs experience higher costs for reasons other than the characteristics of the geographic areas that they serve. Such an attempt to keep

³⁰ The amount of this additional subsidy represents a deadweight loss to society. Providing this additional support artificially increases the amount of the universal service surcharge that customers must pay. The difference between the amount of the surcharge required if only efficient carriers are serving high cost areas, and the amount of the surcharge needed to provide additional support to carriers who incur higher costs for reasons that avoidable, represents a cost with no corresponding benefit (except to the owners of the high cost carriers).

in play two sets of mutually exclusive assumptions is not a step on the path to sound public policy. However uncomfortable the answer may prove to be, it is essential that the question be posed and addressed in a straight-forward way.

To be clear, the necessity of distinguishing – before any of the current proposals are adopted – between “high cost carriers” and “carriers serving high cost areas” is *not* based on an assumption that the ILECs are somehow managing to hide inefficient operations from regulators.³¹ If such an assumption were necessary, the Joint Board and Commission might argue that no evidence has been produced to show that this kind of abuse has occurred, and that in the absence of such evidence they have assumed that ILECs only experience high costs because they service high cost areas. But there is no room for such an argument here: the ILECs have readily acknowledged, and the Joint Board and Commission have likewise concluded, that the ILECs incur higher costs for other reasons; that is, the ILECs are “high cost carriers” for reasons other than the fact that they are carriers who often serve “high cost areas.”

According to the rural ILECs, their costs are higher than the costs of other carriers (including but not limited to wireless CETCs serving the same geographic area) because:

1. They utilize network equipment and facilities that are sized for low levels of demand, causing the per-unit costs that they experience to be higher than the comparable costs of larger carriers,

³¹ The very light-handed oversight of ILECs makes it entirely possible that such inefficient operation has indeed gone undetected, resulting in the appearance of higher costs and in a higher than necessary level of support being provided to ILECs. The point here is that it is not necessary to assume that this has taken place in order to recognize the necessity of distinguishing between “high cost carriers” and “carriers serving high cost areas.”

2. They lack the purchasing power of larger companies, causing the price paid for equipment and facilities to be higher than the amount paid by larger carriers, and

3. They lack operational economies of scale, causing their unit costs to be higher than those experienced by larger carriers.

For the most part, the ILECs are correct when making these claims. In its recommendation, the Joint Board takes note of the fact that larger ILECs experience additional “economies of scale and scope” not experienced by the smaller rural ILECs.³² The Commission has also explicitly recognized the implications of the ILECs’ small size. In its *Fourteenth Report and Order* the Commission concludes that rural ILECs “generally have higher operating and equipment costs,” and these higher costs are caused not only by the fact that the ILECs serve areas with “lower subscriber density,” but are also a direct result of “small exchanges” and “a lack of economies of scale.”³³

The testimony proffered by the rural ILECs in state proceedings to evaluate a potential CETC’s application for ETC designation provide further evidence of the ILEC’s cost structure and, more importantly, provide a useful illustration of the errors in logic that permeate a discussion in which most participants are locked into a false paradigm (here, one in which it is assumed that the *objective* of the federal universal service program is to permit the ILECs, as high cost carriers, to recover the costs that they incur).

³² *Joint Board Recommendation*, ¶41.

³³ *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, FCC 01-157, released May 23, 2001 (“Fourteenth Report and Order”),* ¶5.

In a currently-ongoing proceeding before the Oklahoma Corporation Commission,³⁴ a group of ILECs presented prefiled testimony addressing these issues.³⁵ In his testimony, the ILEC witness argues that it would not be appropriate for the CETC applicant to receive Local Switching Support (“LSS”), and the discussion of this issue in his testimony provides a clear example of how being locked into this false paradigm causes these errors in logic.

In support of his position, the ILEC witness notes that the CETC applicant, if required to qualify for support based on its own costs, would not qualify for the same amount of LSS as a small wireline ILEC. For this reason, he argues, support to a CETC such as the applicant must therefore be excessive. A review of the facts as presented by the ILEC witness reveals how he goes astray. He points out that the CETC applicant uses a single switch to serve approximately 250,000 subscribers in Oklahoma, while rural ILECs typically deploy a switch for each exchange (he further points out that these individual exchanges may have fewer – sometimes far fewer – than 1000 subscribers). For this reason, he correctly points out, the CETC applicant is likely to experience a lower switching cost per subscriber than the rural ILECs. The problem, he explains, is that “there is a limit on how much the cost of a switch can be reduced.” The ILEC witness is factually correct on this point: there is a minimum switch size and it is certainly inefficient to deploy a large number of small switches to serve a group of

³⁴ Cause No. 200700408: Application of United States Cellular Corporation for Designation as an Eligible Telecommunications Carrier and Redefinition of Service Areas Pursuant to the Telecommunications Act of 1996.

³⁵ Mr. Harris’ testimony was filed on behalf of on behalf of Carnegie Telephone Company, Central Oklahoma Telephone Company, Cherokee Telephone Company, Hinton Telephone Company, KanOkla Telephone Association, Medicine Park Telephone Company, Inc., and Panhandle Telephone Cooperative, Inc.

customers that could much more efficiently be served by a single larger switch (or a smaller number of large switches). In economic terms, the ILEC witness has demonstrated that individual rural ILECs (and certainly individual rural ILEC exchanges) are below the minimum efficient size³⁶ for investment in an individual switch.

Having become aware of the economics of the situation, the ILEC witness – because he is locked in the false paradigm of ILEC cost recovery – reaches a conclusion that the “problem” in this scenario is that the CETC applicant, by deploying a single switch to serve a larger number of customers, is able to provide local switching to customers in these same rural, low-density areas more efficiently and at a lower cost. Presumably, if the CETC applicant would simply engage in an overtly inefficient and uneconomic act of deploying a large number of small switches throughout its proposed ETC service area, it would experience higher unit costs (comparable to those experienced by the ILECs) and thereby qualify for LSS. By artificially increasing its costs, the CETC would – according to the logic of the ILEC witness – address any concern regarding the application of the “identical support rule.” But such an approach certainly doesn’t represent rational investment and it cannot represent sound public policy.

The ILEC witness’ choice of words reveals that he is locked into the false paradigm. He states, for example, that “the purpose of Local Switching Support is to offset a portion of the costs of deploying switches in sparsely populated

³⁶ The Utility Regulation Body of Knowledge website (www.regulationbodyofknowledge.org) defines minimum efficient size as “the smallest possible size for a plant to operate relatively close to the minimum average cost for a larger plant.”

areas.” Such a stated purpose – which assumes, *a priori*, that deploying a large number of small switches in sparsely populated areas is the best public policy solution – makes no sense, particularly in light of the fact that the same ILEC witness had already successfully demonstrated that the act of deploying multiple switches throughout sparsely populated areas is inherently inefficient and unduly costly.

Breaking free of the false paradigm permits the issue to be stated in a more meaningful way, and as a result a more rational answer easily manifests itself. If the purpose of the federal universal service program is understood to be the protection of customers (and the task of making services available to them) – rather than a mechanism for ILEC cost recovery – it would make much more sense to state that “the purpose of LSS is to offset a portion of the costs of providing a local switching function to customers located in sparsely populated areas.” With that simple restatement, the predetermined outcome is eliminated and the more logical conclusion becomes clear: if the local switching functionality can be performed more efficiently and at a much lower cost, it makes little sense to reward wireline ILECs for continuing to engage in a highly inefficient practice.³⁷

³⁷ Consistent with the usual ILEC presentation, the Oklahoma witness goes on to assert that a “guiding principle” of the administration of the federal universal service program should be “cost control,” but then argues that the CETC applicant should not be designated as an ETC in the additional requested areas because it operates too efficiently to qualify for a type of support received by many rural ILECs. It appears that the real “problem” with the operation of the CETC applicant in Oklahoma, or any carrier with a similar network design, as an ETC in the geographic areas served by rural wireline ILECs is that such operation brings to light and underscores the inherent inefficiency of small wireline carriers. In terms of an evaluation of the public interest, it is at best unclear how the ILEC witness’ proposal to penalize efficient carriers while continuing to reward carriers that – as he successfully demonstrates in his testimony – are continuing to operate in a way that is inefficient and much more costly than is necessary.

There appears to be little dispute that many of the ILECs are high cost carriers not simply because they serve high cost areas, but because they are well below the minimum efficient size to provide service in a cost-effective manner. Absent the protection of the federal universal service program, market forces would have created strong incentives for the ILECs to become more efficient. This might have occurred through consolidation of companies, through the joint use of resources (to address the issue identified by the ILEC witness in Oklahoma, joint use of a larger switch, for example), or through some combination of other options – but it certainly would have begun to happen. The existing federal universal service program mechanism has shielded the ILECs from the market forces that would have forced them to increase their efficiency, and the current proposal to continue to do so through a POLR Fund means that they will have little or no incentive to address these inefficiencies in the future. As a direct result, the amount of support needed to keep the ILECs in operation is, and will continue to be, higher than necessary in order to meet the true objectives of the federal universal service program: ensuring that customers in rural areas have access to the services they need and want.

While it may be uncomfortable to acknowledge, the undisputed truth is this: no one would look at the need to provide telecommunications services to rural areas and conclude that the current arrangement of over 1400 small independent ILECs³⁸ is the most efficient or rational method of doing so. The

³⁸ The National Exchange Carrier Association (“NECA”) website (www.neca.org) reports that the organization has approximately 1400 members in the small ILEC defined as less than \$40 million in annual revenue) category.

current patchwork of numerous small ILECs exists for historical reasons, but there is absolutely no public policy reason to perpetuate it. Unfortunately, both the *Joint Board Recommendation* and the Commission's NPRM's are based on an untested assumption that the most efficient way to provide service to customers in rural areas is with 1400 individual companies, each with its own independent network and equipment sized to serve only its own relatively small number of customers. Not only is this key assumption not tested, both the Joint Board and the Commission indicate that they already know it to be incorrect: the proposal to eliminate the "identical support rule" is premised on the assumption that a CETC can operate more efficiently and at a lower cost than the ILEC. If the Joint Board and Commission genuinely believe that the high-cost fund is in "dire jeopardy" of "imminent collapse," then it cannot make sense to simply ignore the fact that the group of carriers that receive the majority of universal service support currently incur costs that are higher than necessary to provide service to customers in rural areas. It certainly cannot make sense to acknowledge this highly inefficient cost structure, and yet further institutionalize it by identifying ILECs as a protected class of carriers and setting aside the majority of support for them. Doing so will have two outcomes: (1) it will eliminate any incentive for the ILECs to address these inefficiencies (and prevent the market forces that would otherwise provide this incentive from operating), and (2) it will cause the fund to continue to be larger than necessary in the short run, and much larger than necessary over the long run.

In the end, a conclusion that the “identical support rule” causes CETCs to receive a level of support that exceeds the costs that they incur provides very important – and highly relevant – information about the ILECs upon whose costs that support is based. If the objective is to engage in a comprehensive review that will provide a basis for fundamental reform (or even if the objective is more modest, and simply a desire to adopt sound public policy), the Joint Board and Commission cannot first acknowledge – but then ignore – the fact that a large number of independently-operating small ILECs is not an efficient way to provide telephone service to rural and high cost areas. ILECs are “high cost carriers” not simply because they are “carriers serving high cost areas,” but because in many cases that are below the minimum efficient size and therefore lack economies of scale that are otherwise attainable. In other words, ILECs incur high costs that are not inherent in the geographic areas that they serve, but are in fact avoidable. This fact is fully supported by the numerous observations by ILECs, the Joint Board, and the Commission that CETCs can provide service to the same geographic areas at a lower cost,³⁹ in part because of their economies of scale and in part because most CETCs rely on a technology that represents a more efficient means of providing service in areas of low customer density.

Inexplicably, the current proposals do not seek to address the fundamental problem of too many ILECs that are too small, but instead avoid the appearance of the problem by creating a POLR Fund. Creating a protected class

³⁹ In fact, since a wireless network can provide service to areas beyond the fixed customer locations served by the ILEC’s wireline network, it is more accurate to state that a CTEC is providing service to a larger geographic area at a lower cost.

of carrier for the ILECs assures the continued support of these excessive costs, but generally avoids any discomfort that may be caused when a CETC's costs are compared to the costs of an ILEC serving the same geographic area. By significantly limiting the amount of support available to CETCs, the current proposals will delay the construction of CETC networks in rural areas. This delay provides the "benefit" of further delaying the construction of a second ubiquitous network, ensuring that ILECs can continue to be protected as the only "true" POLRs.

Adoption of the current proposals will create two categories of losers. The first consists of people who live and work in rural areas who will not have access to the services that they need, or whose access to those services will be needlessly delayed. The second consists of all telecommunications customers across the country who will be required to provide, through the universal service surcharge, an amount necessary to ensure cost recovery for 1400 self-described high cost carriers.

The Collection of Uncomfortable Truths, Part 2: The existing mechanism provides no incentives for ILEC efficiency.

By providing a means for what OPASTCO refers to as "genuine cost recovery," the existing mechanism creates no incentives for the ILECs to reduce their costs or to operate efficiently. Any mechanism that permits, and even encourages, any group of carriers to proudly proclaim that they incur higher costs than other carriers to serve a given geographic area, whether it is because they deploy networks that are smaller than the minimum efficient size, lack the

purchasing power of larger carriers, lack operational economies of scale, or some combination of each of these, is decidedly not a mechanism that can properly constrain the size of the federal fund either over the short or long term.

In the *Reverse Auctions NPRM*, the Commission correctly points out (at ¶11) that a support mechanism based on the recovery of a carrier's costs "provides no incentives for ETCs to provide supported services at the minimum possible cost." This observation puts the Joint Board's proposal to continue to provide support to ILECs – based on the recovery of their embedded costs – through the POLR Fund into the correct perspective. If the ILECs are protected as the presumptive current and future POLRs whose support continues to be based on embedded cost recovery, as the Joint Board proposes, the ILECs will continue to have "no incentives to provide supported services at the minimum possible cost" because they will continue to be insulated from market forces that would otherwise provide incentives for them to address their cost structure.

As early as the First Report and Order in CC Docket 96-45, the Commission has correctly pointed out that supporting lower cost carriers will reduce the total amount of support, and therefore the overall size of the fund: "by encouraging more efficient carriers to submit bids reflecting their lower costs, another advantage of a properly structured competitive bidding system would be its ability to reduce the amount of support needed for universal service."⁴⁰

⁴⁰ *Reverse Auctions NPRM*, ¶3. As explained in a previous section of this paper, any form of auction is premature until a second ubiquitous network is in place for a given area. Once this second network is operational, it will then be possible for the more efficient carrier to "submit bids" reflecting its "lower cost."

Two sound conclusions, therefore, have been reached: (1) a cost-based support mechanism, such as the one currently in place for the ILECs, provides “no incentives” for the ILECs to provide services “at the minimum possible cost,” and (2) encouraging more efficient carriers to build out their networks will ultimately result in a reduction in “the amount of support needed for universal service.” It seems reasonable, then, to assume that any proposals set forth in the Joint Board recommendation and the Commission’s NPRMs will be designed to (1) move away from cost-based support for ILECs, and (2) encourage the construction of network facilities by more efficient, lower cost carriers so that the amount of support needed will be reduced. Yet the pending proposals do exactly the opposite: the majority of the federal high-cost fund is proposed to be set aside explicitly for the purpose of providing cost-based support – the type of support that provides “no incentives” for efficiency and lower costs – for the ILECs through the foreseeable future, and support to CETCs that would enable the construction of a second, lower cost ubiquitous network in rural areas – the prerequisite for any process that can reduce the amount of support needed (and the overall size of the high cost fund) over the long term – is being significantly reduced.

The Joint Board makes one additional proposal that should be considered when discussing any efforts to manage the size of the fund over time. At ¶38 of its recommendation, the Joint Board suggests that “support for operation and maintenance” should be available only “for a limited period of time,” and that a transition plan should be developed in order to “wean” a carrier from support

“once the objectives of geographic coverage in an area have been met.” Inexplicably, and with no supporting analysis whatsoever, the Joint Board proposes to apply this proposal to wireless and broadband providers, but not to the ILECs. Such a proposal has no public policy foundation whatsoever. As the ILECs are quick to point out, the “objectives of geographic coverage” for a wireline network in the areas that they serve “have been met.” As a result, an opportunity exists to significantly reduce the size of the existing high-cost fund by “weaning” the ILECs from “support for operation and maintenance” immediately. If, as the ILECs claim, their networks have been built out to all customer locations for some time now, it is reasonable to conclude that a significant portion of the support currently being provided is for “operation and maintenance.” Pursuant to the Joint Board’s reasoning, the ILECs are now past due to be “weaned” from this kind of support.

The only basis that is suggested in the *Joint Board Recommendation* for providing preferential treatment to ILECs – to act to ensure that they are able to receive support for “operation and maintenance” into the foreseeable future, even though their “objectives of geographic coverage” have long been met – is the Joint Board’s assumption that ILECs represent the only potential POLRs, both now and in the future. But such an assumption cannot be reconciled with the Joint Board’s own language: it proposes that the “weaning” of a wireless carrier from “operation and maintenance” support occur “once the [wireless carrier’s] objectives of geographic coverage in an area have been met.” But if the wireless carrier’s objectives of geographic coverage in an area have been met

then – by definition – the wireless CETC is a potential POLR. The Joint Board offers no explanation for its conclusion that if both an ILEC and a wireless CETC both have networks that meet “the objectives of geographic coverage,” that the ILEC should nevertheless be considered the presumptive POLR (and considered so into perpetuity). Once two carriers have networks in place that can meet geographic coverage objectives, the protection of customers (and the objective of ensuring that they have access to the services they want and need) does *not* require that the ILECs continue to be protected from the operation of market forces, or even from eventual failure. In addition, the Joint Board does not explain why it should be in the position of choosing the carrier to be supported going forward, instead of allowing customers to make that selection for themselves.

Finally, support for “operation and maintenance” should, according to the Joint Board,⁴¹ be provided “only when essential.” Once two carriers have networks in place that “meet geographic coverage objectives,” it will be possible, through an auction or other process, to permit the level of support provided in the area to be reduced to a level that reflects the costs of the more efficient carrier. The operation of this process may mean that no support for “operation and maintenance” is in fact necessary. The Joint Board offers no explanation why, given the potential for this scenario, that long term management of the fund is best accomplished by guaranteeing that ILECs continue to receive support for

⁴¹ *Joint Board Recommendation*, ¶54.

their current level of “operation and maintenance” costs, even if it may be determined that such support is not in fact “essential.”

The Collection of Uncomfortable Truths, Part 3: The existing mechanism provides for very little oversight over the use of funds by the carriers who still receive the bulk of the funding.

Although the *Joint Board Recommendation* and the Commission’s NPRMs focus almost exclusively on the receipt and use of high cost support by CETCs, the fact remains that the rural ILECs continue to receive the majority (at least 75%) of the support available to serve customers in the rural ILEC study areas.⁴² Yet the level of oversight over the use of support by CETCs remains much higher than that imposed on ILECs, and the current proposals would continue this disparity.

As a part of the annual review and recertification process, most state regulators require detailed reporting and documentation by CETCs as part of a demonstration that support has been used only for the intended purposes. Most state regulators also require a projection of the CETC’s planned uses of support. In contrast, nearly all state regulators permit the ILECs to simply self-certify that the much larger amount of support that they receive has been used only for the intended purposes.

The ILECs consistently argue that the lower level of oversight of their use of federal universal service support is justified because they receive support for

⁴² In its *Federal Universal Service Support Mechanisms Fund Size Projections for Third Quarter 2008* report, the Universal Service Administration Company (“USAC”) projects total high cost support (HCL, LSS, ICLS and IAS) for rural ILECs of \$666.62 million, support for CETCs of \$218.80, and a total of \$885.42. ILEC support represents 75.28% ($666.62/885.42 = .7528$) of the total.

costs “actually incurred,” while CETCs receive support based on another carrier’s costs. But when examined more closely, this purported distinction offers no legitimate basis for a different level of oversight. The current mechanism provides support to CETCs only for customers served using the CETC’s own facilities. As a result, the CETC must also “actually” incur costs to serve the area before receiving any high cost support for doing so.

The ILEC may indeed have “actually incurred” costs in the area, but no review has taken place of what has caused these costs. The level of costs may be higher than necessary because of any of the various kinds of inefficiency described previously, or the costs may represent investment and expenses actually incurred to provide something other than the supported services. The language of the *Joint Board Recommendation* underscores this problem. At ¶30, the Joint Board observes that “a significant portion of the High Cost Loop fund supports the capital costs of providing broadband-capable loop facilities for rural carriers ... while this program may need adjustments, we recognize its effectiveness in maintaining an essential network of POLRs and in deploying broadband.” While the deployment of broadband facilities in rural areas is a worthwhile objective, it is *not* the stated purpose of the high cost loop fund and broadband access has not been on the list of supported services during the time period being considered. In most cases, an ILEC’s investment in broadband-capable loop facilities is undertaken in geographic areas, and to customer locations, that already have fully-functioning loops capable of providing high quality telephone services (services that include all of the required supported

service functionalities). As a result, these additional investments are not required in order for the ILEC to provide high quality, affordable telephone service. Through its proposed process of continuing to reserve the majority of support for the ILECs to provide basic telephone service and then to look the other way regarding how the support is actually spent, the Joint Board is hoping that, while the ILECs' use of support is not closely monitored, that it is nevertheless being used for some worthwhile purpose (if not actually for the purposes intended, then for some other desirable purpose). But noting that "a significant portion" of high cost support has been used for a purpose not directly related to the intended use and then reaching an "all's well that ends well" conclusion is *not* meaningful oversight. In reality, the Joint Board, Commission, and state regulators do not know how the "majority" of the High Cost Loop fund – the portion provided to ILECs – has been used.

By omitting the comprehensive review and jumping ahead to proposed "solutions" before the objectives have been defined, the Joint Board Recommendation and the NPRMs are based on some important, yet incorrect, implicit assumptions.

The Joint Board Recommendation doesn't define services in a meaningful way.

In its recommendation, the Joint Board seeks to establish three distinct funds, each with "separate distribution mechanisms and separate funding allocations." Pursuant to this proposal, a separate fund will provide support to "mobility" services, "broadband" services, and "voice services at affordable and comparable rates for all rural and non-rural areas." Such a proposal can only

make sense if each of the three categories represents a separate and distinct “service” sought by customers, but this is simply not the case.

In the Joint Board’s assessment, a customer may purchase “mobility,” “broadband,” “voice services,” or some combination of these, but will seek to purchase each capability from a different provider. This approach ignores both technical and market realities.

“Mobility” and “broadband” are not services purchased by customers. “Mobility” is a feature of the voice and data services provided by wireless carriers, and “broadband” describes the amount of capacity available from some carriers who provide data – and increasingly, voice – services. But neither is a standalone service *per se*; a customer cannot purchase “mobility” except as a feature of a voice or data service, and would have no use for “broadband” capability except as a means of obtaining a high-speed data or voice service.

In reality, a customer may elect to purchase the “voice services at affordable and comparable rates” described by the Joint Board from a wireless provider, a broadband provider that may or may not be the ILEC serving the area, or from the ILEC. “Voice services” purchased from a wireless carrier will have the additional capability of “mobility,” “voice services” purchased from a broadband provider (in the form of a VoIP or similar offering) are likely to be part of a service package that includes both voice and high speed data services, and “voice services” obtained from the ILEC are likely to be traditional wireline voice services with no additional capabilities. *But depending on the needs of a given customer, the “voice services” provided by a wireless carrier or a broadband*

provider represent “voice services” that are fully as legitimate as the services provided by the ILECs.

In its proposal, the Joint Board seeks to create two distinct classes of “voice services,” and therefore two distinct classes of service providers. The voice services provided by the ILECs are treated as a uniquely legitimate form of voice service. As a result, the providers of the services declared to be the “true” voice services are, according to the Joint Board, worthy of unique protection as POLRs whose support is locked away for their exclusive use. In contrast, the “voice services” offered by providers other than ILECs represent, in the Joint Board’s view, only a second-rate imitation of the ILEC-provided services. Some amount of support is proposed to be available to these second-class carriers, though it is intended to be limited in scope (in effect, wireless and broadband providers are offered the leftovers after the ILECs have been fully supported) and the Joint Board proposes that its uses be more restricted than the use of funds by the ILECs.

With all due respect to the Joint Board, its opinion of which services – and which service providers – ought to be most important to customers is not the proper consideration. Instead, any proposal should include the ability for customers to make their own decisions and to set their own priorities (and ideally to permit those priorities to evolve over time). Unfortunately, the Joint Board’s three fund proposal moves in the opposite direction – it puts regulators in the position of deciding priorities for customers, and it freezes these priorities in place with no opportunity for customers to change them.

The Joint Board Recommendation and NPRMs fail to recognize that “basic telephone service” is now only a small part of broader service offerings.

The Joint Board recommendation continues to treat stand-alone, fixed, voice-only services as the standard representation of customer wants and needs. But increasingly, the market reality is that what the Joint Board seeks to treat as the core service offering is considered by customers to be only a small part of a much broader service package (a package that includes some combination of mobility, data services, and high-speed access).

In its recommendation, the Joint Board correctly notes (§55) that “the Act explicitly tasks the Joint Board, from time to time, with recommending to the Commission modifications in the definition of the services that are supported by the federal universal service support mechanisms.” But the Act does not state that rural customers should not have the ability to obtain, as a part of the service they purchase, other capabilities (such as those that are available in urban areas), and in no way does the Act suggest that the Joint Board should limit support to only those carriers whose service offerings are limited to the list of supported service functionalities. Yet the Joint Board’s proposal is to do exactly that: by declaring that the “voice services” provided by ILECs are uniquely worthy of protection, it has justified placing the ILECs into a protected class of “true” POLRs for whom the majority of available support is reserved. The adoption of this proposal would put the Joint Board and Commission in the “big brother” role of deciding for customers the scope of the services that they want to purchase and who the provider of those services should be.

The Identical Support Rule NPRM does not properly address the issue of substitution.

In the Identical Support Rule NPRM, the Commission concludes (§9) that wireless CETCs do not provide a “complete substitute for traditional wireline service.” The basis for this conclusion appears to be an observation (§10) that “many households subscribe to both services.”

The Commission has posed the wrong question here. Because customers have not been required to treat wireline and wireless services as mutually-exclusive alternatives, the existing number of subscribers to each service provides no meaningful information at all regarding the potential for substitution. The relevant question is *not* “How many customers have given up their wireline service (i.e. have “cut the cord”) when they subscribe to wireless service?” but rather *“How many customers, if required to choose between wireline and wireless service, would choose to retain wireless service?”*

The answer is likely to vary by geographic area, depending initially on the degree to which a wireless carrier has been able to build out in the area to the degree necessary to provide quality service. Fortunately, the Commission does not have to make this determination, but can – and should – develop a mechanism that will permit customers to make their own choices. A federal universal service program mechanism that does not treat any type of carrier as the presumptive COLR and that provides the support necessary for wireless carriers to build out their networks in rural areas will put the choice of provider where it should be: with rural customers. Once a ubiquitous wireless network is

in operation, customers will be able to choose the service they want from the provider of their choice. If the operation of market forces ultimately means that only one type of carrier remains as the POLR for a given geographic area, it will be the POLR selected by customers who live and work in the area, not a carrier selected by regulators who may be thousands of miles away.

Even if it were meaningful to consider only whether customers in a given geographic area have actually “cut the cord,” the most recently available information suggests that customers – including rural customers – are doing so in increasing numbers. According to the Department of Health and Human Services,⁴³ the percentage of wireless-only households increased from 5.0% in Jan-Jun 2004 to 15.8% in Jul-Dec 2007.⁴⁴ In rural (non-MSA) areas, wireless-only households have increased from 2.9% in Jan-Jun 2004 to 10.0% in Jul-Dec 2007.⁴⁵ As wireless coverage in rural areas has improved, customers have added wireless phones and in increasing numbers have opted to discontinue their wireline service after doing so.

The current proposals are based on a means-end inversion and fail to properly consider program objectives.

The proposed elimination of the “identical support rule” is the primary example of this failure in logic.

Both the Joint Board and the Commission have recommended that the “identical support rule” be eliminated because “the rule bears little or no

⁴³ Centers for Disease Control and Prevention, *Wireless Substitution: Early Release of Estimates from the National Health Interview Survey, July-December 2007*, released May 14, 2008. This report is available at www.cdc.gov/nchs/data/nhis/earlyrelease/wireless200805.htm.

⁴⁴ *Id.*, Table 1.

⁴⁵ *Id.*, Table 2i.

relationship to the amount of money competitive ETCs have invested.” But as addressed previously, simply noting that the “identical support rule” does not accurately reimburse CETCs for their costs says nothing about whether the “identical support rule” is consistent or inconsistent with the objectives of the federal universal service program.

The arguments of the ILECs, and the recommendations of the Joint Board and Commission, regarding the “identical support rule” appear to be based largely on a visceral response that unfortunately is never subjected to further examination. These responses rely on a notion of equity (i.e. it is not “fair for CETC to receive support based on the ILEC’s costs) and occur only within the false paradigm regarding the purpose and objectives of the federal universal service program (an assumption that the purpose of program is to permit carriers to recover the costs that they incur).

The fallacy of the equity argument becomes clear when its implications are considered. The argument is ultimately that it is not “fair” for CETCs to receive the same level of support as ILECs, because CETCs incur lower costs to serve the same geographic area. As a result, the argument continues, “equity” demands that CETCs receive a lower level of support than the ILEC receives to serve the same area. The unavoidable implication of this argument is that the ILECs are arguing for a form of protection against their own inefficiency: rather than permitting market forces to encourage the ILECs to address their cost structures, they seek to have CETCs penalized for being more efficient. Such an approach would reward the self-proclaimed high cost providers for incurring

those high costs, keeping prices higher than necessary and making the size of the fund larger than necessary.

Instead of focusing on how a given mechanism will impact the ILECs, the Joint Board and Commission should instead focus on how it will impact customers. Surely it would not be “fair” to penalize rural customers – in the form of higher prices and fewer service alternatives – in order to insulate the ILECs from the realities of their cost structure.

Any suggestion that CETCs can somehow improperly benefit from a level of support based on the ILEC’s costs is similarly misplaced for two reasons. First, a CETC will have a cost advantage over the ILEC if the “identical support rule” is in place, but it will be exactly the same cost advantage that it would have if both carriers operated in an open market with no support. In contrast, providing a lower level of support to a CETC because its costs are lower causes that legitimate cost advantage to be nullified. Basing support to CETCs on their own (lower) costs would artificially equalize the cost structure of carriers whose costs in reality may be far from equal. Market forces would no longer reward a CETC for using a more efficient technology or operating at or above the minimum efficient size, and the ILECs would continue to be insulated from market forces that would otherwise penalize them for using a higher cost technology or for operating, as the ILECs claim that they do, below the minimum efficient size.

As the Commission points out in the *Identical Support Rule NPRM* (§7), it has consistently defined competitive neutral as meaning “that universal service support mechanisms and rules neither unfairly advantage or disadvantage one

provider over another, and neither unfairly favor nor disfavor one technology over another.” Because the “identical support rule” does not *create* any cost advantage for one type of carrier or another (any cost advantage is a function of the carrier’s operating scale, chosen network technology, and other factors, and exists independently of the method of distributing universal service support) it is fully consistent with this definition of competitive neutrality. In contrast, basing support on a CETC’s cost would nullify any actual, legitimately –earned cost advantage, and by doing so would certainly “unfairly advantage” one type of carrier and “unfairly favor” one technology.

Second, all support received by a CETC – without regard to the CETC’s cost structure – *must* be used for the “provision, maintenance, and upgrading” of facilities used to provide the supported services, and most state regulators carefully review all such expenditures as a part of the CETC’s annual recertification process. Assuming that the CETC’s costs are indeed lower than those of the ILEC, support based on the ILEC’s higher cost will provide funds to enable the carrier that all parties agree is the most efficient, least cost provider to build out its network more quickly. Once this buildout has occurred, it will then be possible to move on to any number of alternatives for “minimizing the amount of universal service support required to meet the program’s objectives.” While it doesn’t provide any artificial benefit to the CETC, an accelerated buildout of network facilities by a lower cost provider will directly benefit rural customers in the geographic area being considered, and will benefit all customers over the long run as total amount of support is minimized.

When the actual objectives of the federal universal service program are considered, it becomes clear that the “identical support rule” actually works quite well: it sends the correct market signals to carriers and permits the buildout of a lower-cost network. There is certainly no public policy basis for the Commission to single out this one rule as a unique justification for engaging in piecemeal reform prior to conducting the necessary comprehensive review of the program.

In the end, the “identical support rule,” like all of the existing methods for distributing support, may or may not be a part of the new universal service mechanism put into place after a comprehensive review that leads to fundamental reform. But whatever the mechanics of the new program turn out to be, it will be necessary to follow a transition path from the current mechanism to the new one. The “identical support rule” meets the requirements of an appropriate transition path: by making the construction of a second ubiquitous network possible (and potentially to be constructed more quickly), this method of distributing support provides movement toward several options for “minimizing the amount of universal service support required to meet the program’s objectives.” In contrast, the elimination of the “identical support rule,” done as a part of the contemplated piecemeal reform to be undertaken without the benefit of a comprehensive review, will represents steps in the opposite direction of a transition path toward these future options.

The Path Forward

True “fundamental reform” of the federal universal service program must begin with a “comprehensive review,” and until this review takes place the Commission will not have the information necessary to determine whether any of the proposals to change individual elements of the program represent steps toward, or away from, the ultimate goal. One thing is certain: engaging in the kind of piecemeal reform contemplated in the *Joint Board Recommendation* and the NPRMs without first identifying a set of objectives, developing a mechanism to meet those objectives (a mechanism that is not artificially constrained by the existing elements of the program), and identifying a transition path from the existing to the new mechanism, is a risky gambit that the current circumstances do not warrant.

The first essential step on the path to fundamental reform is to take a step back and engage in a comprehensive review of all elements of the program. No existing service providers, and none of the existing program mechanisms, should be considered sacrosanct. Truly fundamental reform – reform that can serve to ensure that people who live and work in rural areas have access to the services that they want and need and that can serve to minimize the funding requirements over the long run – must not be subject to “but we’ve never done it that way” or “but those carriers or that technology have been around for a long time” artificial constraints.

The Commission should resist the urge to take action simply for the sake of taking action. There has been no demonstration that the current situation compels such a risky move. Instead, the Commission should adopt a “do no

harm” approach: any actions that have the potential to be a move away from, rather than toward, any likely set of objectives should be avoided. In the present context, the elimination of the “identical support rule,” while appealing at some visceral level, would significantly delay the deployment of a second ubiquitous network in many rural areas. Such a delay would be a decided step backward from many of the potential proposals to “controlling fund growth and ensuring a move to most efficient technology over time,” including but not limited to the various proposals for auctions.

Pursue available options to reduce the level of required support in the short term.

If the Commission is truly convinced that the high-cost fund is in “dire jeopardy” of “imminent collapse,” then several options are available that are fully consistent with a “do no harm” approach. The following options would serve to control fund size in the short term while the comprehensive review takes place, but would not create undue delay in the construction of CETC networks. As a result, these approaches have the decided advantage of addressing the size of the fund in the short term while not delaying the construction of the networks necessary for “controlling fund growth and ensuring a move to the most efficient technology” over the long run.

1. Require the disaggregation of ILEC support at the wire center level.

47 CFR §54.315 permits, but does not mandate, the disaggregation of support to reflect identified cost differences. In the *Identical Support Rule NPRM*, the Commission concludes that

The identical support rule fails to create efficient investment incentives for competitive ETCs ... the competitive ETC has little incentive to invest in, or expand, its own facilities in areas with low population densities ... Instead, competitive ETCs have a greater incentive to expand the number of subscribers, particularly those located in the lower-cost parts of high-cost areas, rather than to expand the geographic scope of their networks.⁴⁶

Setting aside the issue of whether the Commission's observations can be factually supported, if the Commission is truly concerned that CETCs have insufficient incentive to invest in high cost areas, the disaggregation of ILEC support represents a fully effective means of addressing the issue. If support is disaggregated in a way that reasonably reflects geographic differences in cost, then a CETC that simply increases the number of subscribers located in "the lower-cost parts of high-cost areas" will receive little support. Conversely, a CETC that "invest(s) in, or expand(s), its own facilities in areas with low population densities" will qualify for a higher level of support reflective of the higher costs associated with the lower population density of the area. As a result, the disaggregation of support creates the correct incentive structure for CETCs: little or no support for serving additional customers in areas with relatively lower costs, and an increased amount of support for expanding service into the relatively higher cost areas. Fully addressing the concerns set forth by the Commission in the *Identical Support Rule NPRM* does not require that the "identical support rule" be eliminated, but rather requires that available support be effectively targeted to the higher cost areas.

2. Exercise greater scrutiny of the use of support by all ETCs.

⁴⁶ Identical Support Rule NPRM, ¶10.

Most CETCs are currently subject to much greater scrutiny by state regulators regarding their use of support than are the ILECs. A careful examination of the use of support by CETCs should continue, but there is no legitimate reason to exempt the ILECs from this level of oversight simply because they are the original recipients of universal service support. Rural ILECs still receive over 75% of the support in the geographic areas that they serve. If the use of funds by only one type of carrier is to be fully examined, it would make sense to “go where the money is” and to consider the ILEC’s expenditures. Of course, there is no such constraint: it is possible and appropriate to fully examine the use of support by all ETCs, including both ILECs and CETCs.

The language of the Joint Board recommendation also suggests an additional reason that the use of funds by the ILECs should be subject to additional scrutiny. Since the ILECs’ objectives of geographic coverage in an area” have largely been met, it may be time, according to the Joint Board’s reasoning, to begin to “wean” these carriers from high cost support. The fact that the ILECs no longer require the use of support in order to “expand the geographic scope of their networks” suggests that it would be a worthwhile exercise to determine exactly how the support is being used.

Finally, an argument that the ILECs are being reimbursed for costs already incurred does not address the issue of whether further scrutiny is warranted. The mere fact that money has been spent does not address the issue of how it was spent. And the “costs already incurred” situation is not

unique to ILECs; CETCs receive support only for customers served using their own facilities, so they likewise have already incurred costs to serve the area.

3. Act on the Commission's previous decision to base ILEC support on economic costs.

As the Commission has previously concluded, basing support on forward-looking economic costs provides a more accurate level of support and sends the correct signals to carriers who are considering entering a given geographic market:

Support based on forward-looking cost is sufficient for the provision of the supported services and sends the correct signals for entry, investment, and innovation ... In rejecting arguments for basing support on a carrier's embedded cost, the Commission agreed with the Joint Board that "to the extent that it differs from forward-looking economic cost, embedded costs provide the wrong signals to potential entrants and existing carriers."⁴⁷

The primary concern that has been expressed to date is that no economic cost model has been developed that can be used to accurately calculate the economic cost of rural ILECs, *if* model inputs developed for non-rural companies are used: "as some commenters point out, the Rural Task Force's analysis of the forward-looking mechanism was based on the results of running the existing high-cost universal service model for rural companies using non-rural inputs ... if inputs based on rural carrier data had been used, however, many of these differences could have been eliminated."⁴⁸ The Commission's observation raises two important points to consider. First, it can be concluded that the objective to

⁴⁷ *Fourteenth Report and Order*, ¶174, including footnote 406.

⁴⁸ *Id.*, ¶175.

base support on forward-looking economic costs is a reasonable one that can be attained, though some additional work may be required. Second, the question of the appropriate “rural carrier data” to be used must be carefully considered: higher costs currently incurred by many high-cost rural ILECs that are ultimately avoidable – that is, not caused simply by the fact that the ILEC is a carrier serving a high cost area – should not be included in the costs used to develop the level of support. Doing so would further institutionalize the existing inefficiency of serving rural areas with a very large number of very small ILECs, making the fund larger than necessary over the long run.

In the end, while finalizing work on a model and the development of appropriate inputs would require some effort on the part of industry participants and regulators, the task is not insurmountable; indeed, there appears to be some broad industry consensus regarding a workable starting point.⁴⁹ Once these tasks have been undertaken, the results would provide the clear benefits of a sufficient level of support; correct signals for entry, investment, and innovation; and a smaller overall fund size.

4. Implement truly portable support for all ETCs.

Under the existing mechanism, support is fully portable among CETCs; that is, if a customer discontinues receiving service from a CETC, that CETC loses the support associated with that customer. In direct contrast, if a customer

⁴⁹ Such a model need not be developed from the ground up, but instead can be created with some additional development to existing cost models. In several interconnection arbitrations, rural ILECs have relied upon the output of the HAI model (release 5.0a) as the basis for their proposed reciprocal compensation rates. While some additional work will be required to address some previously-identified issues with the model, it is apparent that many rural ILECs consider HAI to represent a reasonable starting point for economic cost development for rural areas.

elects to no longer receive support from an ILEC, the ILEC nevertheless continues to receive the same total amount of support. As customers – including rural customers – increasingly begin to “cut the cord,” making support truly portable would result in a decrease in the total amount of support required.

Work toward the long term.

Until a second ubiquitous network is operational in a given area, auctions and similar mechanisms for “controlling fund growth and ensuring a move to the most efficient technology” over the long run are premature. In the short run, the Commission can act to encourage rural investment by CETCs so that these networks will be in place as quickly as possible (at a minimum, the Commission should ensure that any short-term actions that it takes do not delay this investment). This approach will provide a path to several options, including but not limited to one of the various forms of auctions, for effective long-term management of the fund.